UNITED STATES ATTORNEY'S OFFICE
NEWS RELEASE

March 22, 2007 -

SOMERSET, NJ COMPANY AGREES TO PLEAD GUILTY TO FAILING TO PAY TAXES ON MORE THAN $99 MILLION WORTH OF EMPLOYEE STOCK BONUSES

Government to Receive More Than $42 Million In Fines, Taxes, Penalties, And Interest

United States Attorney Pat Meehan and I.R.S. Special Agent-in-Charge of the Criminal Investigation Division Peter S. Alvarado today announced the filing today of an Information* charging New Jersey-based E-Star, Inc. with failing to pay federal taxes on more than $99 million in employee stock bonuses. It also was announced that E-Star will plead guilty to this charge. By the time of sentencing, E-Star, Inc. and its parent company Hon Hai Precision Industry Company Ltd., will have paid more than $29 million in criminal fines, taxes, penalties, and interest.

Specifically, the Information charges that from January 1998 through December 2002, defendant E-Star, Inc. and related companies located in the United States paid some of their employees compensation in the form of stock bonuses, but did not collect, account for, or pay over to the Internal Revenue Service ("IRS") the taxes due and owing under the Federal Insurance Contributions Act ("FICA"), i.e., social security and Medicare taxes. The Information alleges that the approximate total sum of FICA taxes which the defendant and related companies did not collect, account for, or pay over was $3,464,436.

"The integrity of our tax system depends on honest reporting and the law applies to both companies and individuals," said Meehan. "In this case, you had more than $99 million in stock bonuses that were never reported."

According to the Information and the factual allegations in the government's change of plea memorandum, filed on March 22, 2007, as well as representations contained within the attachments to the government's change of plea memorandum, defendant E-Star, Inc. participated in a scheme to pay certain employees of the defendant and of other related companies, bonuses in the form of shares of stock of Hon Hai Precision Industry Company, Ltd. ("Hon Hai"), the ultimate parent company of the defendant, without collecting, accounting for or paying over to the IRS, the social security and Medicare taxes ("FICA") due upon those employee stock bonuses, in violation of 26 U.S.C. § 7202.

"The tax law is very clear," said Alvarado. "It is the responsibility of each employer to withhold employment taxes from the salaries of their employees, even if the salaries are paid in stock. Those employers who don't are committing a crime."

Hon Hai Precision Industry Company Ltd. U.S. Branch (“Hon Hai U.S. branch”) is the United States branch of Hon Hai, a large multinational corporation based in Taiwan, which manufactures computer-related equipment. The stock of Hon Hai is publicly traded in Taiwan, but not in the United States. From 1998 through 2002, Hon Hai had numerous subsidiaries located in the United States, particularly in California, Texas and New Jersey. One such subsidiary, defendant E-Star, Inc., was located at Somerset, New Jersey, and was involved in the overall operation of the manufacture of computer-related equipment.

During the years 1998 through 2002, Hon Hai and its subsidiaries, including defendant E-Star, Inc., issued stock bonuses to many of their employees. Approximately $99 million dollars worth of total stock bonuses were awarded and vested during the relevant time period. However, Hon Hai and its subsidiaries, including E-Star, never reported these stock bonuses to the IRS on any annual or quarterly tax returns, or on any reporting form, such as a IRS Form W-2 or, alternatively, an IRS Form 1099. Moreover, the bonuses represented W-2 wages from which defendant E-Star, Inc. and the other companies, as employers, were obligated to withhold FICA taxes, and report on the quarterly payroll tax returns, IRS Forms 941. The required FICA withholdings, after taking into consideration the fact that the statutory withholding requirement is reduced as wages rise, collectively equals approximately $3,464,436.

According to the government’s change of plea memorandum, when a new U.S. employee of defendant E-Star, Inc. or another Hon Hai subsidiary, received a certain salary level or above, that new employee typically would enter into a compensation agreement under which the employee would receive a certain amount of shares over three years, usually in October, after the completion of at least one year of successful work. For example, an employee hired in 1998 would be told, either orally or in writing, that he or she would receive 5,000 Hon Hai shares in 1999; 3,000 shares in 2000; and 2,000 shares in 2001. The stock awards were actual shares of stock, that is, direct bonuses, rather than stock options. Further, they typically followed the 50% – 30% – 20% disbursement rate over the three years. When the employee finally received the first disbursement of shares, he or she would receive a “pink slip:” a pink piece of paper, written in Chinese, listing the amount of shares granted, and when. The value of the shares at any given time would fluctuate based on their price on the Taiwan stock exchange.

When an employee wanted to sell the stock, and thereby realize its value, he or she would, directly or indirectly, email or contact a Hon Hai employee in Taiwan, and request that X shares of stock be sold. The employee also would provide his or her bank account information. The shares would be sold on a foreign exchange. Taiwanese taxes, which generally applied to the par value of the stock and represented a very small percentage of the total sale proceeds, would be withheld. The remaining proceeds then would be wire transferred to the destination of the employee’s choice, usually either a U.S. bank, an overseas bank account, or a relative in Taiwan.

Defendant E-Star, Inc. and the other Hon Hai subsidiaries had a system in place, including a non-automated system of record keeping, regarding the stock bonus distributions. For years, E-Star and the other companies had a practice of: including a reference to the potential stock bonuses within some (a minority) hiring letters; distributing the “pink slips” to employees regarding their bonuses; creating and obtaining supervisory approval of the stock bonus spread sheets; frequently tying the amount of an employee’s stock bonus grant to his or her employee performance review; and maintaining the system of selling the stock overseas through employees in Taiwan. Thus, the stock bonus program was no accident, and it applied broadly and for many years.

No later than calendar year 2002, a number of employees of defendant E-Star, Inc. and other Hon Hai subsidiaries had begun asking the management questions about the tax treatment of the stock bonus program. In 2002 and early 2003, a number of present and past employees of E-Star and other subsidiaries would testify that they had asked Hon Hai management whether their stock bonuses had been reported to the IRS, and/or whether United States income taxes had been paid on their stock bonuses. The answers received by the employees from the companies were inconclusive and confusing. Some of those employees then made an independent decision to pay United States income taxes on the stock bonuses, after consulting with their own accountants on the issue.

The accountants for Hon Hai, Price Waterhouse Coopers ("PWC"), worked on the Hon Hai account from 1999 to the present, preparing annual corporate income tax returns for the various companies, as well as providing generalized accounting and financial services. No one from defendant E-Star, Inc. or the other companies ever disclosed to PWC that there was a stock bonus program. The management of defendant E-Star, Inc. and other Hon Hai subsidiaries, however, had knowledge that no taxes ever were collected, reported or paid to the IRS by the defendant or the related companies regarding the stock bonus income. No later than 2002, management of defendant E-Star, Inc. and other subsidiaries had been put on notice by the employee inquiries that the stock bonus program violated United States tax laws because no withholdings had been made and no reportings of the stock bonuses had been made to the IRS as required by law. Knowing that the stock bonuses represented income to the employees of E-Star and the other Hon Hai subsidiaries, from which E-Star and the other Hon Hai subsidiaries, as employers, were obligated to withhold FICA taxes and report on the quarterly payroll tax returns, Forms 941, and having been put on notice of the stock bonus program's illegality, defendant E-Star, Inc. willfully failed to collect and truthfully account for and pay over to the IRS the employer's share of FICA taxes due and owing to the United States of America for the quarter ending December 31, 2002.

The government's change of plea memorandum also alleges that, on June 3, 2003, federal search warrants were executed at the offices of certain Hon Hai subsidiaries located in California and Texas. Pursuant to the warrants, the government seized records concerning the stock bonus scheme. After execution of the warrants, a number of high-level officials of various Hon Hai subsidiaries who had received stock bonuses, filed amended individual tax returns for the years 1998 through 2002. As a result, the IRS received approximately $12.9 million in income taxes owing on the stock bonus income reported on those amended returns.

The government's change of plea memorandum reflects that defendant E-Star, Inc. has informed the United States through its counsel that the corporation intends to enter a guilty plea to the Information. A guilty plea hearing has not been scheduled to date.

The guilty plea agreement entered into by defendant E-Star, Inc. and the government, attached to the government's change of plea memorandum, reflects that the parties agree that the amount of the back taxes due as FICA taxes is approximately $3,464,436. Further, the defendant has agreed to pay a criminal fine in the amount of $6,928,872 at or before the time of sentencing. The government has agreed not to prosecute any present or former directors, officers or employees of defendant E-Star, Inc., Hon Hai; Hon Hai U.S. branch, and/or the United States subsidiaries of Hon Hai, but only if those directors, officers and employees who received stock bonuses file accurate amended federal income tax returns which report those stock bonuses as income in the years in which they were received. These accurate amended tax returns must be filed no later than April 10, 2007, unless other arrangements are made in writing with the IRS.

Attached to the parties' guilty plea agreement is an IRS Form 906, which is a civil tax closing agreement between Hon Hai and related subsidiaries and affiliates. In this agreement, Hon Hai and related subsidiaries and affiliates agree to pay to the IRS in regards to the 1998 through 2002 tax years a total amount of $13,214,580 in combined FICA taxes due and owing, and related penalties and interest, including a civil fraud penalty for the 2002 tax year. The civil closing agreement also reflects that Hon Hai and related subsidiaries and affiliates also already have deposited with the IRS approximately $9,121,161 in additional FICA taxes collected and reported for the 2003 through 2005 tax years.

Accordingly, and during this investigation, and without regard to any additional amended returns to be filed by April 10, 2007, the government either already has collected, or will collect under the terms of the parties' agreements, a combined total of over $42 million dollars in criminal fines, FICA taxes, individual income taxes, and civil penalties and interest.

DEFENDANT	ADDRESS	AGE [Date of Birth]
E-Star, Inc.	Somerset, New Jersey	N/A

If convicted, the defendant faces a maximum possible sentence of a fine of up to twice the gross loss or gain resulting from the offense, five years of probation, and a $400 special assessment.

The case was investigated by the Internal Revenue Service-Criminal Investigation, and has been assigned to Assistant United States Attorneys Mary E. Crawley and Peter D. Hardy.

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